Commentary

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A CANADIAN-U.S. DISPUTE SETTLEMENT MECHANISM: BINDING OR EFFECTIVE?

A rash of recent public statements from a wide spectrum of opinion leaders, from federal ministers to provincial premiers to editorial writers, suggests that Canada's bottom line in the current trade negotiations with the United States must be a binding dispute settlement mechanism. Not everyone making such statements seems clear, however, on just what this involves. In any case, it seems ill advised to become committed, as a bottom line, to a means to some end rather than to the end itself. Canada's objective in the bilateral trade negotiations is to gain secure access to the U.S. market; all specific demands are merely means to that end.

At this time, it is important to be clear on what Canada's reasonable bottom line should be. If the negotiations succeed, the public's expectations may be disappointed merely because an agreement does not include a mechanism to resolve trade disputes in ways that are legally binding on both countries. This creates the danger that Canadian decisionmakers might reject an otherwise beneficial agreement. If the negotiations fail, Canadian-U.S. trade relations will enter a new and difficult period. In that event, it would be important to know whether the negotiations failed because Canadians made unreasonable demands or because reasonable Canadian demands were rejected.

The Objective

Canada's objective in the present trade talks is to gain secure access to the U.S. market. The stress is on secure, because the application of U.S. trade laws now makes that access insecure even in areas where existing tariffs are low. Given such current uncertainties, a successful Canadian firm's best method of gaining secure access is to locate in the United States and so avoid present, or anticipated, U.S. restrictions -- such as countervailing duties -- on imports.

Canadian exporters now face an ever-widening array of U.S. trade restrictions in such industries as fish, pork and hogs, softwood lumber, steel, and potash -- restrictions resulting from over 50 separate U.S. trade actions against Canada in the past six years. The unilateral U.S. decisionmaking process reviews government subsidies and other in-

dustrial policies in the country that is exporting to the United States, but not U.S. subsidies and policies for its own domestic industry.

The U.S. trade law system is consistent, in principle, with the requirements of the General Agreement on Tariffs and Trade (GATT). In practice, however, it has deviated substantially from the GATT's requirement of objective, "technical-track" investigations. There is mounting evidence that the technical work of the U.S. International Trade Commission and even the U.S. Department of Commerce (in the softwood lumber case) has become politicized.[1] Put more succinctly, the problem is the process by which U.S. trade law is administered, and it is becoming clear that a new, more balanced process is needed.

Of particular concern is the fact that, in a 1986 decision on Canadian softwood lumber, the United States reversed an earlier decision that had favored Canada. This reversal demonstrated to Canadian exporters that they now must operate in a climate of uncertainty about their future access to the U.S. market.

The omnibus trade bill now winding its way through the U.S. Congress threatens to create a broader array of techniques with which to harass successful Canadian exporters. The process itself is becoming increasingly expensive for those who defend themselves successfully and the outcomes more serious for those who fail. Manufacturing firms can opt to move to the United States -- and they have done so increasingly in recent years -- but resource-based industries have little recourse but to live with greater uncertainty.

Canadians now fear -- correctly, in our view -- that the United States will attempt to react to their success in penetrating the U.S. market by imposing duties that cannot be resisted effectively, given the current application of U.S. trade laws.

The Means

To be effective, a Canadian-U.S. trade agreement requires some rules to determine which subsidies are allowable and which are countervailable. The simple economic principle on which these rules should be based is that only subsidies that seriously distort the pattern of trade are unacceptable; all others are tolerable. In terms of specifics, however, giving effect to this principle is, of course, a much more difficult matter. For example, internal Canadian transfer payments, such as regional development grants, medicare, and unemployment insurance programs, are now vulnerable to U.S. trade law procedures; they will become even more vulnerable if a new version of the U.S. trade bill is passed. In a bilateral trade agreement, it is necessary to distinguish such domestic policies from trade-distorting subsidies.

If an agreement is reached on a subsidies code, then the issue will be whether or not specific practices are acceptable within the terms of the agreement. For example, is a specific regional development subsidy condoned or outlawed by the language and the intent of the agreement? These are bilateral issues, and it is quite unacceptable to Canada that they be settled by a unilateral U.S. process into which Canadians have little input. Thus, the trade agreement will require some sort of a bilateral dispute settlement mechanism in the form of a joint trade commission.

The joint commission would administer the bilateral agreement. Critical to its credibility and ultimate success is how the commission is staffed. It should include equal numbers of Canadians and Americans. Appointments should be based on expertise in international trade and trade law rather than on patronage. This would help stem the recent trend toward greater politicization of domestic trade law processes.

As a general principle, for dispute settlement to be effective, Canada and

the United States should agree that all future petitions made under the provisions of the U.S. Trade Act of 1979 and Canada's 1984 Special Import Measures Act be referred to the joint trade commission. The commission would have a specified period to investigate complaints, hold hearings, publish informed reports in which staff from both countries would participate, and thereby resolve trade disputes. Such a procedure would review evidence of injury due to subsidized exports objectively, and from the viewpoint of both countries, rather than in the one-dimensional manner in which individual country investigations are now made.

Negotiating Options

Since it is becoming clear that neither country intends to abandon its existing trade laws, how should a new joint trade commission fit into the existing system?

Two Unacceptable Options

At one extreme, the joint commission would replace domestic procedures now used to deal with bilateral trade disputes. Since the commission would be created to administer provisions of the new bilateral trade agreement, Canada would not need to receive a total exemption from U.S. countervailing duty laws. Existing Canadian and U.S. trade laws, of course, also would remain in force to be applied against third parties. The commission would determine whether a particular practice -- export subsidy, regional development program, and so on -- fell within the terms of the bilateral trade agreement. Where it did not, the commission would make rulings -- binding on both countries -- on such matters as injury, causation, and appropriate remedies. From a Canadian perspective, this approach is highly desirable as a negotiating objective, but it is unlikely to be adopted. Influential members of the U.S. Congress have indicated repeatedly that they would not accept having so much authority turned over to a joint body.

At the other extreme, any complaint about unfair trade in the bilateral context could be referred simultaneously to the joint commission and to the domestic trade law process. In our view, this parallel process of investigation would not be much different from the status quo and, thus, would not accomplish what is needed. A thorough investigation, fair to both sides, usually would take longer than the mandated timetable for domestic procedures. Domestic trade bodies would continue to take unilateral, potentially harmful decisions just as they now do -- with little input from a joint commission that would give equal weight to the defending country's case.

It seems to us that to achieve Canada's goal of security of access to the U.S. market, a plan is needed that is intermediate between one extreme that appears politically unacceptable and another that is ineffective. Two intermediate cases seem attractive.

The Third Option

One solution would be to use the joint commission as the first forum in which complaints are heard. If one of the parties in a dispute were to object to the commission's decision, it then could proceed with an unfair trade complaint through the present domestic trade law system. This would be an improvement over the present situation in that the domestic trade bodies then would be able to use all of the evidence presented to the joint commission to inform their own analyses, which, presumably, would lead to better decisions than those obtained under current procedures. It would also put moral pressure on the domestic trade bodies to deviate from the joint commission's decisions only when they can articulate reasons for doing so. Frivolous overturning of the joint commission's findings would be difficult, although not impossible.

If disappointed parties were to appeal the joint commission's rulings regularly through the domestic trade law

system, the cost and time needed to resolve disputes would be greatly increased. Nonetheless, this approach would be an improvement over the present unilateral decisionmaking process. We feel that this is the minimum institutional guarantee of security of access that Canada should accept. It is, however, up to the negotiating teams and the two countries' trade officials to judge whether or not the gains would outweigh the costs, in terms of necessary compromises, to obtain this essential institutional reform.

The Fourth Option

Another possibility would be to agree to grant the joint commission the primary authority to determine whether particular practices subject to dispute were allowed or disallowed under the bilateral free trade agreement. For example, if the commission were to find that a particular subsidy was allowed, the complaint would be rejected, thus precluding the complainant's recourse to the domestic trade law process. If the commission were to find, however, that the practice was not allowed, then the domestic trade law process would be used, as it now is, to determine injury and appropriate remedies.[2] There is a reasonable likelihood that the offending government subsequently would alter its policy as a result of unfavorable rulings by the joint commission. Again, timing is all-important: by having first crack at gathering evidence on the dispute, the joint trade commission would improve on the current, unilateral process. An incremental process for resolving trade disputes is a worthwhile option.

Conclusion

In the current bilateral trade talks, Canadian negotiators should be working toward agreement on an effective trade dispute settlement mechanism. A binding mechanism would be desirable, but a joint trade commission would help to resolve many of the current problems in the administration of trade laws. The commission's decisions need to be made before those of the domestic agencies. If the negotiating teams cannot agree on a dispute settlement mechanism, they may fail to conclude a useful bilateral trade agreement, one which -- from Canada's perspective -- could significantly reduce the escalation of U.S. protectionism.

The resolution of international trade disputes is an evolutionary process. An agreement that accepted freer trade in goods and services in principle and that included a new institutional framework -- in the form of a joint trade commission -- would be a major improvement over the status quo. Agreement on a subsidies code and other rules would aid the work of the joint commission, but it is not as essential as the actual establishment of the commission itself. Once this key institution is in place, Canada would move closer to its ultimate goal of secure access to the U.S. market.

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Notes

1. See Alan M. Rugman and Andrew Anderson, Administered Protection in America (London: Croom Helm; New York: Methuen, 1987).

2. For further discussion, see Debra Steger, "Dispute Settlement in a Canadian-U.S. Free Trade Area," TradeTrends (World Trade Centre Vancouver), September 1987. We have also benefited from discussions with Murray Smith.